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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. [redacted] 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,

A Creditor.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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TABLE OF CONTENTS.

	PAGE
PETITION FOR WRIT OF CERTIORARI:	
JURISDICTION	2
NATURE OF THE PROCEEDINGS	2
THE QUESTIONS PRESENTED	4
SUMMARY STATEMENT OF MATTERS INVOLVED	5
REASONS WHY A WRIT OF CERTIORARI SHOULD ISSUE	13
BRIEF IN SUPPORT OF PETITION:	
OPINIONS BELOW	23
STATEMENT OF THE CASE	23
POINT I—The Bankruptcy Court had jurisdiction to determine the nature and extent of the State's lien for taxes on a claim filed in the proceedings, and, in particular, the rate of interest or penalties to be allowed thereon after bankruptcy	23
(A) The Bankruptcy Court has exclusive jurisdiction, from the date a petition is filed, over liens and claims asserted against a debtor	25
(B) Under bankruptcy law the State has no lien on the personal property of the debtor	28
POINT II—The State repealed its railroad tax law and attempted by a new tax act to preserve its taxes as assessed and preserve and extend its lien after bankruptcy had occurred	30

APPENDIX: PAGE

(A) APPLICABLE PROVISIONS OF THE BANKRUPTCY ACT 35

Section 2 (a) (2) (11 U. S. C. A. Ch. 2, Section 11) 35
Section 57 (11 U. S. C. A. 93) 35
Section 64 (11 U. S. C. A. 104) 36
Section 67 (11 U. S. C. A. 107) 36
Section 77(b) (11 U. S. C. A. 205 (b)) 37

(B) RAILROAD TAX SETTLEMENT ACT OF 1941 (Chapter 290) 38

(C) RAILROAD TAX SETTLEMENT ACT OF 1942 (Chapter 241) 43

Table of Citations.

Cases:	Page
Acme Harvesting Co. v. *Beckman Lumber Co.*, 222 U. S. 300	26
Arkansas Corp. Comm. v. *Thompson*, 313 U. S. 132	19
Attorney General v. *Dover*, 62 N. J. L. 138	17
Camden v. *Allen*, 26 N. J. L. 398	24
Camden v. *Mayhew*, 129 U. S. 73	16
Central Railroad Co. of N. J., In Re, 136 Fed. (2d) 633	12, 21
Central Railroad Co., in re, 152 Fed. (2d) 408	23
Chicot County Drainage Dist. v. *Baxter State Bank*, 308 U. S. 371	17
City of New Orleans v. *Harrell*, 134 Fed. (2d) 399	29
City of New York v. *Hall*, 139 Fed. (2d) 935	29
Clark v. *Barnard*, 108 U. S. 436	16
Coast Co. v. *Spring Lake*, 56 N. J. Eq. 615	17
Continental Illinois Nat'l Bank v. *Chicago, Rock Island Pac. Ry. Co.*, 294 U. S. 648	26
Re Diamond, 259 Fed. 70	26
Dixon v. *Jersey City*, 37 N. J. L. 39	24, 32
J. A. Dougherty & Sons v. *Commissioner of Internal Revenue*, 121 Fed. (2d) 700	17
Drexel v. *Loomis*, 35 Fed. (2d) 800	15
Erie Railroad v. *Tompkins*, 304 U. S. 64	18
Ex Parte City Bank of New Orleans, 3 How. 291	25
Gross v. *Irving Trust Co.*, 289 U. S. 342	26
Gunter v. *Atlantic Coast Line*, 200 U. S. 373	16
Re Hollingsworth & Whitney Co., 242 Fed. 753	16
Hyman v. *Long Branch Kennel Club*, 115 N. J. L. 123	17
Isaacs v. *Hobbs Tie & Timber Co.*, 282 U. S. 734	14, 19, 25
Lang v. *Bayonne*, 74 N. J. L. 455	17

PAGE

Lyford v. *New York*, 140 Fed. (2d) 840 29

National Bank v. *Bloom*, 113 N. J. L. 597 20
Nelson v. *Loder*, 132 N. Y. 288 14
Nisbit v. *Federal T. & G. Co.*, 229 Fed. 644 25
New Jersey v. *Anderson*, 203 U. S. 483 20
New York v. *Maclay*, 288 U. S. 290 29

Re Opinion of the Justices, 266 Mass. 590; 165 N. E. 904 18

Re Pennsylvania Central Brewing Co., 114 Fed. (2d) 1010 29
Pennsylvania T. & T. v. *Gummere*, 87 N. J. L. 353 .... 24, 33
Pitney, et al., Trustees v. *New Jersey*, 320 U. S. 805 21
Porto Rico v. *Ramos*, 232 U. S. 627 16
Prawl v. *Burckhartt*, 299 Ill. 19; 132 N. E. 280 18
In re Public Utility Board, 83 N. J. L. 303 17
Pullman Couch Co. v. *Eshelman*, 1 Fed. (2d) 885 15

In re Riggi Bros., Inc. 42 Fed. (2d) 174 15
In re Rival Knitting Co., 289 Fed. 960 16
Rutten v. *Paterson*, 73 N. J. L. 467 18

Shields v. *Lozear*, 22 N. J. Eq. 447 14
In re Sobod, Inc., 25 Fed. Sup. 344; aff'd. 103 Fed. (2d) 1019 16
State, Dixon, Pros. v. *Jersey City*, 37 N. J. L. 39 .... 24, 32
Straton v. *New*, 283 U. S. 218 ..... 14, 19, 32

Taubel &c. v. *Fox*, 264 U. S. 426 25

Taylor v. *Sternberg*, 293 U. S. 490 26
Town of Belvidere v. *Warren Railroad Co.*, 34 N. J. L. 193 24

United States v. *Texas*, 314 U. S. 480 29

In re Van Camp Products Co., 95 Fed. (2d) 206; cert. den. 305 U. S. 605 15

Wilentz v. *Hendrickson*, 133 N. J. Eq. 447; 135 N. J. Eq. 244 ..... 8, 10, 11, 12, 18, 24, 25

STATUTES:

	PAGE
Bankruptcy Act, Section 27	5, 15, 17
Bankruptcy Act, Section 57	14
Bankruptcy Act, Section 64	14, 29
Bankruptcy Act, Section 67	14, 29
Bankruptcy Act, Section 77	5, 13, 14
Judicial Code, Sec. 240(a) (28 U. S. C. Sec. 347 (a))	2
N. J. Constitution, Art. I, Par. 20	11
New Jersey Railroad Tax Act, 54:27-4	30
New Tax Act, Section 75	6, 30
Rev. 54.29A-53	31
Rev. 54:29A-54	31
Rev. 54:29A-55	31
Rev. 54:29A-75	32
Chapter 290, P. L. 1941	6, 7, 9, 38
Chapter 291, P. L. 1941	6, 8, 9
Chapter 169, P. L. 1942	8
Chapter 241, P. L. 1942	8, 9, 10, 11, 19, 43

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THE STATE OF NEW JERSEY

A Creditor.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable The Chief Justice and the Associate Justices of the Supreme Court of the United States:

WALTER P. GARDNER, surviving trustee of The Central Railroad Company of New Jersey, a debtor corporation in bankruptcy under Section 77 of the Bankruptcy Act, petitions for a writ of certiorari to review a decision of the Circuit Court of Appeals for the Third Circuit reversing Order No. 271 of the United States District Court for the District of New Jersey sitting in bankruptcy.

Jurisdiction.

Judgment of the Circuit Court of Appeals was entered November 15, 1945. The opinion of the Circuit Court of Appeals is reported in 152 Fed. (2d) 408. A petition for rehearing was denied March 28, 1946. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, 28 U.S.C. Section 347(a) as amended by the Act of February 13, 1925.

The Nature of the Proceedings.

This case arises from a petition of the trustees to the District Court to determine these essential questions:

(1) Whether a compromise had been entered into between the State of New Jersey (which had filed a claim in the proceedings for balances of taxes assessed by the State upon property and franchises of the debtor for the years 1932 to 1939 both inclusive in the amount of $12,117,450.68, plus interest thereon in the sum of $7,732,339.53, plus additional interest at 1% per month on the unpaid taxes from December 1, 1940 to the date of payment) and the trustees, under and in strict compliance with Railroad Tax Settlement Acts passed by the State, under which, before the constitutionality of said Acts was determined the trustees on court order had accepted the offer of settlement therein contained; had discontinued all pending appeals from taxes; had made payments of disputed taxes that would not otherwise have been paid; after all of which it was impossible to have the *status quo* reinstated.

(2) Whether, if no contract of compromise existed, to what extent the claim of the State against the debtor should be allowed in the bankruptcy proceeding; and

(3) What are the relative rights, claims, liens and priorities of the claimants in the assets of the debtor's estate.

Upon the filing of said petition the Attorney General of New Jersey filed a special appearance and contended that the Bankruptcy Court was without jurisdiction to make the determination of the matters aforesaid, on the ground that the petition of the trustees constituted a suit against the State without its consent. The District Court thereupon referred the matter to a Special Master, who filed an Interim Report that the entire property of the railroad is in *custodia legis,* and that the Bankruptcy Court is the proper court to determine the validity and amount of the tax claims of the State and incidental liens and that the Trustees Petition for adjudication of liens should not be dismissed. Objections were filed by the State to this report, and the District Court after a hearing made Order No. 271 confirming the Interim Report of the Special Master. The attorney general appealed from this order. Before the case was heard in the Circuit Court of Appeals the Attorney General of the State filed in the Circuit Court of Appeals a petition for writ of prohibition praying that the Circuit Court of Appeals forbid the District Court and Special Master from making any adjudication in connection with the tax debt liens of the State.

The Circuit Court of Appeals denied the petition for a writ of prohibition and in its opinion said:

> "the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment. * * *
>
> "In No. 8889 Order No. 271 of the District Court is reversed. This disposes of the entire matter before us. The application for a writ of prohibition

in No. 8861 is therefore dismissed, without costs to either party as against the other."

This, when read with the judgment reversing Order 271, was an instruction that the amount of the state's taxes and penalties and the lien asserted was *res judicata* and no longer open to further litigation.

The trustee filed a petition for rehearing asserting that the Court had misconceived the questions involved on the appeal and had determined the matter as though only the assessments and amount of taxes were involved, whereas the questions actually presented are those above stated relating to the status of the compromise under the Railroad Tax Settlement Acts, the rate of interest to be allowed on the State's claim, and the nature and extent of the liens against the debtor's property. The petition for rehearing was denied, and this petition for a writ of certiorari is filed within due time.

The Questions Presented.

I.

Does the Bankruptcy Court have jurisdiction to determine the nature and extent of liens of a State for taxes assessed against the property and franchises of a railroad in reorganization under Section 77 of the Bankruptcy Act and in particular the rate of interest or penalties to be allowed thereon after bankruptcy?

II.

Where trustees in bankruptcy have accepted, pursuant to court order, an offer of settlement contained in statutes of the claimant State, and in compliance with such statutes have abandoned all pending contests of the amount and nature of assessments, and the *status quo* cannot be re-

stored, does the later determination by the State Courts that the Settlement Acts are unconstitutional in a proceeding to which the trustees in bankruptcy were not parties, prevent the Bankruptcy Court from itself determining whether or not the State's claim for taxes and penalties was compromised in accordance with the provisions of Sec. 27 of the Bankruptcy Act (11 U. S. C. A. Sec. 50) and must be allowed and paid over a period of years, and at a reduced rate of interest, as fixed by the Tax Settlement Acts?

III.

Is not the jurisdiction of the Bankruptcy Court to make such determination clear where the decision of the State Court was made on the finding that there was no moral or equitable consideration to support the State's remitting, cancelling and abating the interest and penalties accruing against the several railroads doing business in the State, and that consequently the statute amounted to a "donation of land or appropriation of money" in violation of a provision of the State Constitution; whereas in the case at bar the debtor Railroad was unable to pay the taxes and continue its public functions, and the consideration to support the settlement was the discontinuance of litigation involving the taxes and the payment of retroactively assessed additional taxes without contest?

Summary Statement of Matters Involved.

On October 30, 1939 The Central Railroad Company of New Jersey, hereafter called the "Debtor", filed its petition in the District Court for the District of New Jersey under Section 77 of the Bankruptcy Act, because the State had threatened to enter judgment and sell its properties located within the State for nonpayment of 1932 and 1933

taxes, litigation concerning which had resulted unfavorably to the debtor. Trustees were appointed for the debtor on January 8, 1940. The State of New Jersey by its Comptroller filed a claim for taxes, which specified the amount of taxes due for each year from 1932 to 1939 inclusive, the balance remaining unpaid for each year and the interest and penalties that had accrued to the date of bankruptcy App. 82a-87a). At this time practically all the railroads in New Jersey were in default in the payment of their franchise and property taxes and a number were in bankruptcy. The Governor of the State appointed a committee to investigate the railroad tax problem, which had resulted to a major extent from a grossly inflated tax rate, and that committee, on February 22, 1941, made a comprehensive report which was subsequently considered by a committee of the Legislature, with the result that Chapters 290 and 291 of the Laws of 1941 were passed and approved and became effective July 22, 1941. Chapter 291, P. L. 1941, was a new Railroad Tax Act providing for taxes on both the franchises and properties of railroads doing business in the State. This act, in Sec. 75 repealed the former tax act under which the taxes were assessed, and in Sec. 54 attempted both to preserve the taxes theretofore assessed and also to *extend the lien* to revenues and other personal property not theretofore covered by a state lien. (See brief annexed, p. 30.)

By the provisions of Chapter 290 the State Treasurer was authorized and required to accept, without interest penalties, instalment payments of the principal amount of the taxes assessed and unpaid for the years 1932 to 1940 inclusive,* provided the railroad taxpayer complied with Sections 7 and 8 of said Act, which provided as follows:

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* A true copy of Chapter 290, the 1941 Tax Settlement Act is printed in the appendix hereto.

"7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

"8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require."

On August 8, 1941 the District Court considered this statutory offer of settlement and authorized the trustees of the debtor to accept the compromise of said tax claims by agreeing to pay the full unpaid balance of the principal amount of taxes assessed from 1932 to 1940 inclusive, said payments to be made in instalments over a period of twenty years, as authorized by said Act, without penalties but with interest at three percent per annum, computed from December 1, 1940 as required by the terms of said offer (app. 62a, par. 14).

The trustees thereupon filed with and delivered to the appropriate officer of the State all the documents and pay-

ments required for full compliance by them and subsidiary companies with the conditions of said offer and the order of the Court. After this had been done, and on September 4, 1941, the Attorney General, David T. Wilentz instituted a proceeding in the Court of Chancery of New Jersey against the State Treasurer, Hendrickson as defendant, attacking the constitutionality of Chapter 290 (app. 63a).

Neither the debtor nor its trustees, nor any railroad was a party to this suit in the Court of Chancery instituted by the Attorney General against the State Treasurer, Hendrickson.

Before the enactment of Chapter 290 aforesaid your trustees had appealed to the New Jersey State Board of Tax Appeals from the assessment of railroad taxes made for the year 1941. The taxes for the years 1934-1940, inclusive, were all in litigation before various administrative tribunals and courts. Having accepted the State's offer of compromise on court order, they paid the taxes assessed for 1941 and discontinued all appeals and pending litigation over the taxes as assessed for the years 1932 to 1941 inclusive. While *Wilentz* v. *Hendrickson* above mentioned was still pending undetermined, the Legislature enacted Chapter 169, P.L. 1942, effective May 8, 1942, amending certain provisions of Chapter 291, P.L. 1941 (the new Railroad Tax Act), so as to levy a retroactive franchise tax against the debtor for the preceding year 1941 in the additional amount of $239,749.80, but which law also operated to reduce the franchise taxes assessed for 1941 against most of the other railroads operating in New Jersey and completely to eliminate from franchise taxes certain other railroads operating in New Jersey. Petitioner believed that said Chapter arbitrarily and unjustly discriminated as between members of the class of railroad taxpayers subject to the Railroad Tax Act of the State and singled out the

debtor as a victim of an arbitrary recomputation of the 1941 franchise taxes, while at the same time financially benefiting other railroad taxpayers (app. 65a).

Thereupon the Legislature of New Jersey enacted Chapter 241, P.L. 1942 approved and effective May 21, 1942, amending in various respects Chapter 290, P.L. 1941 (the Tax Settlement Act).* Chapter 241 added various burdens and conditions to those imposed upon the debtor by the Act which it amended. Among other things it provided that:

> "taxpayer desiring to accept the provisions of this act shall, on or before June 15th, nineteen hundred and forty-two, file with the State Treasurer the acceptance documents required by this act * * * waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December 1st, nineteen hundred and forty-one, *pursuant to the applicable tax acts and of any assessment heretofore or hereafter made for the tax year nineteen hundred and forty-one.* * * *"

To accept the benefit of the 1942 Tax Settlement Act the trustees were required unequivocally to abandon their challenge of the retroactive additional franchise tax for 1941 in the amount of $239,748.80, and to incorporate in their "Acceptance Document" their written waiver of "any and all rights to contest the legality or amount" of said retroactive franchise tax assessment, and also any other tax that might thereafter be assessed for said year, or risk the contention that they had abandoned their acceptance of the State's offer or had failed in any respect to comply therewith in good faith. The Trustees were also required by Chapter 241 to make an additional interest payment on or

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* A true copy of Chapter 241, P. L. 1942, is printed in the appendix hereto.

before June 15, 1942 in an amount exceeding $340,000.00 which resulted from the requirement of accelerated payment of interest and the requirement that interest be computed from December 1, 1940 upon the entire principal amount of taxes claimed by the State as of that date, without deducting therefrom the first instalment of principal previously computed. The trustees had only between May 21, 1942 when this act was approved and June 15, 1942 to secure court approval of the acceptance of the settlement contained in Chapter 241, P.L. 1942, and to comply therewith. This approval was obtained, and the Act was fully complied with by the trustees making the payments and filing all the documents and papers required by State law (App. 66a-68a).

The very day that Chapter 241, P.L. 1942 was approved by the Governor, Vice Chancellor Jayne in *Wilentz* v. *Hendrickson* granted an order to show cause restraining the State Treasurer from carrying out or executing any of its provisions.*

Over a year after the trustees had compiled, and caused their four affiliated companies to comply with Chapter 241, P.L. 1942, and had in good faith waived all of their rights of contest and had paid without contest the retroactive franchise tax of $239,748.80 and the additional and accelerated interest above mentioned, the Court of Chancery, on September 28, 1943, entered a final decree in *Wilentz* v. *Hendrickson*, reported 133 N.J. Eq. 447. The Vice Chancellor held that the Railroad Settlement Acts vio-

*The State Treasurer has not cashed certified checks tendered by the trustees for taxes assessed before 1940. The trustees have preserved their rights to date by making legal tenders of all amounts due to date according to the terms of the Tax Settlement Acts, and said tenders are being kept good. The State Treasurer is holding, uncashed, trustees certified checks aggregating $3,577,689.52. The total of certified checks both held and rejected by the State Treasurer is $8,571,874.46.

lated Article I, Paragraph 20 of the New Jersey Constitution, which provides:

> "No donation of land or appropriation of money shall be made by the State or any municipal corporation, to or for the use of any society, association or corporation whatever."

The State Treasurer duly appealed to the New Jersey Court of Errors and Appeals, which, on June 22, 1944 filed its opinion affirming the decree of the Vice Chancellor, on the ground that the remission, cancellation and abatement of the delinquent interest due from the railroads in the State was not supported by a legal, equitable or moral consideration and that accordingly Art. I, Par. 20 of the Constitution was violated. *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, 260.

The order of the District Court which directed the trustees of the debtor to comply with Chapter 241, P.L. 1942, on or before June 15, 1942, also fixed and determined the amount of the State's claim for taxes. The Attorney General of the State appealed from this order, on the ground among others, that it in fact determined that the Tax Settlement Acts were constitutional, a question that had not been argued, and the Circuit Court of Appeals reversed so much of the order as determined the amount of taxes due the State and said:

> "One final point must be noticed. Order No. 163 authorizes the trustees of the debtor to comply with the Tax Settlement Acts by executing and filing the documents and making the payments therein required. Since the law directed that these steps be taken on or before June 15, 1942, it is vitally important to the debtor, in case the constitutionality of the Tax Settlement Acts is ultimately sustained, that the

tenders made by the trustees prior to that date, pursuant to the directions of Order No. 163, be not invalidated by the reversal of that order. Accordingly so much of paragraphs 6 and 7 of Order No. 163 as authorizes the trustee to comply with the requirements of the Tax Settlement Acts will not be disturbed."

The cause was remanded

> "with directions to the District Court to await the determination by the Court of Chancery of the State of New Jersey of the constitutionality of the Railroad Tax Settlement Acts, unless it finds that delay which may be harmful to the Debtor and its creditors may result, in which event it may proceed itself to hear and decide the constitutional issue."

In re Central Railroad Company of New Jersey, 136 Fed. (2d) 633; rehearing denied July 15, 1942. This court denied certiorari 320 U. S. 805.

Within two months after the decision of the Court of Errors and Appeals in *Wilentz* v. *Hendrickson,* 135 N. J. Eq. 244, and on August 14, 1944, the trustees herein filed their "Petition for Adjudication Concerning New Jersey Tax Claims" (App. 55a), in which they stated the facts as hereinabove contained concerning the taxes assessed, the litigation respecting taxes, and what had been done to comply with the Tax Settlement Acts, and prayed the Court promptly adjudicate (1) whether petitioners entered into a contract with the State of New Jersey, (2) whether such contract is binding on the parties thereto, (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them, (4) if not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed, (5) what order should in such event be

made to restore the equivalent of the status quo ante as nearly as may be and (6) what in such event are the relative rights, claims, liens and priorities of the claimants in the assets of the Debtor's Estate (App. 79a).

The Attorney General, after being served with a copy of this petition, filed a special appearance and alleged that the District Court did not have jurisdiction to make the determination prayed for (App. 100a). The District Court thereupon referred the matter and the State's objections to the Special Master by Order No. 250 (App. 103a). The Special Master made his interim report (App. 148a) in favor of the court's jurisdiction, which was confirmed after hearing objections filed by the State by Order No. 271, which is involved in this appeal (App. 177a). Since the Circuit Court of Appeals denied the State's petition for a writ of prohibition, that is not brought before this Court.

Reasons Why a Writ of Certiorari Should Issue.

I.

The Circuit Court of Appeals by its decision passed upon matters not properly before it and which had not been passed upon by the Bankruptcy Court, consequently its judgment is erroneous, and must be reversed with instructions to the Bankruptcy Court to decide the matters presented by the Trustees' petition.

The judgment of the Circuit Court of Appeals has deprived the Bankruptcy Court of its essential jurisdiction to pass upon these questions:—

(A) Whether the Bankruptcy Court has jurisdiction under Section 77 to determine the nature and extent of a State's lien for taxes on a claim filed in the proceedings, and, in particular, the rate of interest or penalties to be allowed thereon after bankruptcy.

The effect of the judgment of the Circuit Court of Appeals is to deny this jurisdiction. The necessity for the exercise of such jurisdiction is emphasized by the State's repeal of its statute under which the taxes were assessed, and the passage of a new Tax Act which attempted both to *save* the lien of the taxes formerly assessed and *extend the lien* given by the former law to cover additional property (see Brief annexed, pages 27, 28); and by the passage of the Tax Settlement Acts and the consequences thereof to the estate of the debtor. Furthermore, the priorities of liens of bondholders and the State, if any, on the various classes of railroad properties affected by such liens must be determined under Section 67 (B) and (C) and Section 64 (A) 4 of the Bankruptcy Act.

Incidental questions arise whether, because of the facts and circumstances of this case the Bankruptcy Court should not in any event exercise its equity jurisdiction to do equity (Section 77 (A) and Section 2-a of the Bankruptcy Act), by determining that in no event should the State's claim carry penalty interest at 1% per month, but only compensatory interest at a lesser rate (Section 57 (J) of the Bankruptcy Act); or, that because of the tenders made by the Trustees to the State which have been kept good, the running of interest and penalties was stopped by such tenders. *Shields* v. *Lozear*, 22 N. J. Eq. 447; *Nelson* v. *Loder*, 132 N. Y. 288.

Under these circumstances, "while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation." *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U.S. 734, 738, and cases cited.

Straton v. *New*, 283 U. S. 318.

B. *The question is presented whether the State made a valid and binding agreement of compromise with an officer of the Bankruptcy Court.* There was a solemn offer, contained in paragraph 7 of the 1941 Act (page 41 hereof), to the trustees of debtor to settle the tax claims of the State. This offer was duly accepted under the orders of the Bankruptcy Court and the consideration was paid before any attack was made on the constitutionality of the Act. The rights that flowed from such acceptance must be determined by the Bankruptcy Court.

The Circuit Court of Appeals has prevented decision of the question whether a State which has filed in reorganization proceedings a claim for taxes and penalties is bound by the provisions of Section 27 of the Bankruptcy Act, 11 U.S.C.A., Section 50, which provides:

> "A trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate."

There is ample precedent for a bankruptcy court to settle claims against or in favor of an estate in bankruptcy.

Drexel v. *Loomis* (8th Cir.), 35 Fed. (2d) 800;
Pullman Couch Co. v. *Eshelman* (4th Cir.), 1 Fed. (2d) 885;
In re Riggi Bros., Inc. (2nd Cir.), 42 Fed. (2d) 174;
In re Van Camp Products Co., 95 Fed. (2d) 206; cert. den. 305 U.S. 605.

When an individual compromises a claim against the estate with court approval:

> "The court after approval has power by summary order to hold a defaulting offeror to performance of the compromise. This because the offeror by making his offer has subjected himself to the jur-

isdiction of the court so far as the compromise is concerned."

In re Sobod, Inc., 25 Fed. Supp. 344; affirmed 103 Fed. (2d) 1019;

Re Hollingsworth & Whitney Co., (1st Cir.) 242 Fed. 753.

The case of a judicial sale is a fair analogy. A court which has ordered a sale of property in its care may order a defaulting purchaser to carry out the bargain he made. *Camden* v. *Mayhew*, 129 U.S. 73; *In re Rival Knitting Company*, (2nd Cir.) 289 Fed. 960.

Certainly where the claimant is a State a different rule of law should not apply, for the offer of compromise was made by the Legislature with the Governor's approval, which is the most solemn form of offer of compromise that a State could make. Moreover, the State had prior to passage of the statute entered the proceedings as a creditor and its verified claim was before the court for allowance and adjudication. Moreover, that very claim asserted a lien and a priority over all creditors (App. 82a).

The docket entries show that the State had appeared in the proceedings on December 15, 1939, December 2, 1940, March 26, 1941, and on December 12, 1944 it filed an elaborate Reply to "Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey (App. 115a-142a).

Assuming for purposes of argument that the Trustee's petition for an adjudication of the State's claim for taxes was a suit against the State, which we deny, by filing a claim to recover its tax debt the State has waived its immunity from suit.

Clark v. *Barnard*, 108 U. S. 436, 447;

Gunter v. *Atlantic Coast Line*, 200 U. S. 273, 284;

Porto Rico v. *Ramos*, 232 U. S. 627.

The language of Section 27 of the Bankruptcy Act that a trustee may "compromise any controversy arising in the administration of the Estate", is broad enough to include controversies with municipalities, states and the Federal Government, as well as claims of individuals.

Our contention that the debtor's estate is entitled to the benefits of the compromise is supported by the decisions of this Court, the Circuit Court of Appeals for the Third Circuit, and the New Jersey Courts.

> "The actual existence of a statute, prior to such a determination (of unconstitutionality) is an operative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration. The effect of the subsequent ruling as to invalidity may have to be considered in various aspects—with respect to particular relations, individual and corporate, and particular conduct, private and official. Questions of rights claimed to have become vested, of status, of prior determinations deemed to have finality and acted upon accordingly, of public policy in the light of the nature both of the statute and of its previous application, demand examination." Chief Justice Hughes in *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U. S. 371, 374.

J. A. Dougherty & Sons v. *Commissioner of Internal Revenue* (C. C. A. 3d), 121 Fed. Rep. (2d) 700; *The Coast Company* v. *Spring Lake*, 56 N. J. Eq. 615, 620; *Attorney General* v. *Dover*, 62 N. J. L. 138, 140; *Lang* v. *Bayonne*, 74 N. J. L. 455; *In Re Public Utility Board*, 83 N. J. L. 303; *Hyman* v. *Long Branch Kennel Club*, 115 N. J. L. 123.

In effect the Circuit Court of Appeals has ruled that the Bankruptcy Court must follow the decision of the Court of

Errors and Appeals in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, without any hearing or adjudication of the questions here presented. The trustee contends that this decision is not *res judicata* and does not have the support of the doctrine of *stare decisis* under the rule in *Erie Railroad* v. *Tompkins*, 304 U. S. 64, for the reason that it was tried on ex parte affidavits and on an agreed statement of facts, was between the Attorney General of the State as complainant and only the State Treasurer as defendant, and merely resulted in a decree restraining the State Treasurer from complying with the Act. The rule in New Jersey is that:

> "A decision based upon stipulated facts that results in declaring a law unconstitutional does not wipe the act from the statute books, but merely denies its efficacy to a party who has admitted the existence of a state of facts that in the opinion of the court renders the law unconstitutional." (Justice Pitney in *Rutten* v. *Paterson*, 73 N. J. L. 467, 475.)

The opinion of the Court of Errors and Appeals was in the nature of an advisory opinion.

> *In re Opinion of the Justices*, 266 Mass. 590; 165 N. E. 904;
> *Prawl* v. *Burckhartt*, 299 Ill. 19; 132 N. E. 280.

That the Act might be held unconstitutional in the contest between two State Officers on a stipulation of facts, and yet be constitutional as to the trustees of the debtor who had complied with the Act giving a valid and legal consideration in acceptance of the offer of settlement contained therein, is indicated by the severability clause of the

Settlement Act of 1941, as amended by Chapter 241 of the Laws of 1942. See annexed appendix, p. 42 (Par. 12); p. 54 (Par. 15):

> "If any provision of this Act or the application thereof to any person or circumstances is held invalid, the remainder of this Act, or the application thereof to other persons or circumstances shall not be affected thereby."

Whether debtor's estate shall have the benefit of this clause of the Settlement Acts is for the Bankruptcy Court to decide. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734; *Straton* v. *New*, 283 U. S. 318.

In *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132, the trustee was denied the right to have taxes against a railroad's property redetermined and revised in the Bankruptcy Court because he had deliberately failed and neglected to take the appeal to the State reviewing agency, and thence to the courts as the State law permitted. In this case the trustees had taken and were prosecuting all the appeals and legal proceedings provided under the State laws when the Legislature passed, and the Governor approved the Tax Settlement Acts. The trustees, with the court's approval, accepted the offer of compromise contained in the 1941 act and did everything required by the State law to comply with its terms.*

When the 1942 amendment was passed the court and trustees had only six weeks within which to comply with the settlement offer as contained in the statute, and on court

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* The Attorney General declined to approve the settlement papers tendered before he filed his suit in the Court of Chancery. This was merely a ministerial act and it has never been asserted that the papers tendered were not a full compliance with the statute.

order, after notice to the State and all other parties, they fully complied within that time and made every payment and delivered every document required by the statute.* The payment of taxes and the discontinuance of the appeals and litigation amounted to giving the State adequate consideration to constitute a valid contract of settlement. Consideration may be a detriment incurred by the grantee, or a benefit received by the grantor. A trifling inconvenience to the one party or a slight advantage to the other is sufficient to constitute lawful consideration. *National Bank* v. *Bloom*, 113 N. J. L. 597, 602 (E. & Ap.).

A State's claim for franchise taxes was ordered reduced and allowed for the reduced amount in *New Jersey* v. *Anderson*, 203 U.S. 483. In the case at bar the trustee does not contend for a reduction in the principal amount of the taxes as assessed. His insistment is that under all the facts and circumstances of this case the principal of the State's claim for taxes is payable in installments, and that penalties at one percent per month from the dates of the respective annual assessments must be reduced to three percent per annum from December 1st, 1940 on all unpaid installments because of the contract of settlement and compromise that flowed from the Tax Settlement acts.**

The questions presented by this petition have never been decided in any litigation involving the debtor and its estate. We have examined the petition for a writ of certiorari filed by the trustees to review the decision of the

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* The 1942 Act prescribed the form of documents to be delivered and the approval of the Attorney General as to form was not required.

** The principal of taxes claimed by the State to be due is $13,438,668.19 (including in addition to the taxes shown in the State's proof of claim a balance of 1940 taxes of $1,321,218.51); penalties of 1% a month to March 1, 1946 are believed to aggregate $16,267,563.36, a total of about $29,706,231.55.

Circuit Court of Appeals for the Third Circuit in *In Re Central Railroad Company of New Jersey,* 136 Fed. (2d) 633; cert. den., *Pitney, et al., Trustees* v. *State of New Jersey,* 320 U. S. 805 (No. 534, October Term, 1943). Counsel believe that the court denied a writ at that time because the Circuit Court of Appeals made no final determination but sent the case back to the District Court to await the decision of the State Courts, giving that court, however, the right to decide the question of constitutionality of the Tax Settlement Acts before the decision of the State Courts if that were necessary.

Indeed, the brief of the Attorney General of New Jersey filed in opposition to the granting of a writ of certiorari to the trustees of the debtor (No. 534 Oct. Term 1943), stated that there was nothing in the record then before the court effective to bar the Bankruptcy Court from making a determination as to the amount and validity of the tax claims of the State under Sections 77 and 64 of the Bankruptcy Act, after the Court of Errors and Appeals had determined the pending appeal from the Court of Chancery (State's Brief, pp. 8, 9, 13, 14, 18).

Prayer.

For the foregoing reasons your petitioner prays that a writ of certiorari may issue out of this court to the United States Circuit Court of Appeals for the Third Circuit, commanding said Court to certify and send to this Court on a day to be determined, the full and complete transcript of the record of all the proceedings of such Circuit Court of Appeals had in this case, to the end that the case may be reviewed and determined by this Court;

that the judgment of the Circuit Court of Appeals be reversed, and that petitioner be granted such other and further relief as may be proper.

Dated April 18, 1946.

WALTER P. GARDNER,
Surviving Trustee of The Central Railroad Company of New Jersey, The Debtor,

By JAMES D. CARPENTER, JR.,
HOWARD L. KERN,
ALEXANDER H. ELDER,
Attorneys for Petitioner,
75 Montgomery Street,
Jersey City 2, N. J.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The District Court's opinion appears in the Appendix page 175a. The opinion of the Circuit Court of Appeals is reported 152 Fed. (2d) 408 and is annexed to the Appendix, the record below. The Special Master's Interim Report is in the Appendix, page 148a.

Statement of the Case.

A summary statement of the case is given in the petition, pages 5-13 above.

It seems appropriate, however, to emphasize that a fundamental error in the Circuit Court's decision is that by reversing the Bankruptcy Court's order which merely dealt with jurisdiction, the Circuit Court's decision in effect anticipates and undertakes to dispose of meritorious issues as to which the petitioner has had no hearing. Certain of these issues will be defined below.

POINT I.

The Bankruptcy Court had jurisdiction to determine the nature and extent of the State's lien for taxes on a claim filed in the proceedings, and, in particular, the rate of interest or penalties to be allowed thereon after bankruptcy.

The principal amount due on the claims of the State had on to be conceded by the trustees when they accepted the offer of settlement that was contained in the Railroad

Tax Settlement Acts of 1941 and 1942 which were duly passed by the Legislature of New Jersey and approved by the Governor. The trustee asserts the right of the debtor to pay the principal of these taxes in instalments over a period of twenty years, as provided in the Tax Settlement Acts. He further claims that the interest on all taxes unpaid runs at three percent per annum only from December 1, 1940 instead of at the rate of one percent per month from December 1st of the year of the respective assessments as claimed by the State in its claim on file. The claim of the State appears in the Appendix as Schedule "A", page 82a (see Petition for Adjudication, App. 55a).

At the time the trustees of the debtor were appointed, it was the settled law in New Jersey that taxes in arrears due to the State might be compromised, and also that the interest of one percent per month was a penalty and not a part of the tax.

> *Town of Belvidere* v. *Warren Railroad Co.*, 34 N. J. L. 193;
> *Dixon* v. *Jersey City*, 37 N. J. L. 39;
> *Camden* v. *Allen*, 26 N. J. L. 398;
> *Pennsylvania T. & T. Co.* v. *Gummere*, 87 N. J. L. 358.

In a powerful dissenting opinion of Justice (now Chief Justice) Case, in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 261, 281, Justice Case said:

> "By the weight of judicial decisions in this State the percentum addition, whatever name be given to it, is not a part of the tax. It is a form of remedy provided for the collection of the tax. The statute which authorizes the addition may be lawfully re-

pealed, and with the repeal the obligation to pay ceases. Control thereover is within the province of the Legislature."

The majority opinion in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, changed the pre-existing law and held that the penalties specified as such in the statute were in fact interest and a part of the tax debt which could not be compromised unless the State received valuable consideration therefor.

It is clear from the authorities cited in the dissenting opinion of Justice Case that the District Court and the trustees were fully justified in believing when they accepted the provisions of compromise in the Tax Settlement Act, that such compromise was authorized by State law.

A. The Bankruptcy Court has exclusive jurisdiction, from the date a petition is filed, over liens and claims asserted against a debtor.

In 1845, in *Ex parte The City Bank of New Orleans*, 3 How. 291, 11 L. Ed. 603 (Story, J.), it was held that the District Court when sitting in bankruptcy has jurisdiction over liens and mortgages existing upon the property of the bankrupt so as to inquire into their validity and extent and grant the same relief which the State courts might or ought to grant.

The same case held that the control of the District Courts over proceedings in the State courts upon such liens is exercised not over the State courts themselves, but upon the parties, through an injunction or other appropriate proceeding in equity.

See, also:

Taubel &c. v. *Fox*, 264 U. S. 426;
Nisbit v. *Federal Title & G. Co.*, 229 Fed. 644;
Isaacs v. *Hobbs Tie & Timber Co.*, 282 U. S. 374.

Upon adjudication in bankruptcy,

> "The jurisdiction of the bankruptcy court becomes paramount and exclusive, and thereafter that court's possession and control of the estate cannot be affected by proceedings in other courts, whether State or Federal."
>
> *Gross* v. *Irving Trust Co.*, 289 U. S. 342, 344;
> *Acme Harvesting Co.* v. *Beekman Lumber Co.*, 222 U. S. 300, 307;
> *Re Diamond*, 259 Fed. 70, 73;
> *Taylor* v. *Sternberg*, 293 U. S. 470, 472.

The provisions of Section 77 of the Bankruptcy Act permitting a railroad corporation which is insolvent, or unable to meet its debts as they mature, to effect a plan of reorganization through a proceeding in a bankruptcy court, are within the power conferred upon Congress by Art. I, §8, Cl. 4, of the Federal Constitution, to establish uniform laws on the subject of bankruptcies throughout the United States.

> *Continental Illinois Natl. & Trust Co.* v. *Chicago Rock Island Pacific Ry. Co.*, 294 U. S. 648.

An important question presented by the trustees' petition for determination of liens, which must be determined before the Railroad can be reorganized, is as to the priority of liens under Section 64 of the Bankruptcy Act between the State of New Jersey and the bondholders. This question is accentuated in importance by the attempt of New Jersey to extend its liens to the revenues of the Railroad and "all the real and personal property owned, used or controlled by the taxpayer within this State".

While the Trustees' petition did not attempt to specify all the liens that must be determined by the District Court, nevertheless the reference to the Special Master that was made on the Trustees' Petition for Adjudication of the Railroad claims was broad enough to require the Special Master to determine priorities between all the various lien holders.

The effect of the judgment of the Circuit Court of Appeals is to deny the jurisdiction of the Bankruptcy Court to determine the nature and extent of the various liens on the properties of the debtor, and particularly priorities as between the several lien claims in such properties.

When it is considered that ever since the compromise of the State's claim under the 1941 and 1942 Tax Settlement Acts was accomplished, so far as the District Court and the trustees could complete it, penalties have been accumulating, according to the State's contention, at the rate of over $130,000 a month and at this time exceed the principal amount of the taxes claimed by the State by over $3,000,000, the gravity of the questions involved becomes apparent.

If the Circuit Court of Appeals rendered its opinion and judgment with the thought in mind that the questions presented by the Trustees' petition might be settled in a plan of reorganization, the court was grievously mistaken.

How can an intelligent plan of reorganization be prepared until the classes of creditors and the nature and extent and amount of the various liens are determined? Moreover, before a plan is prepared the Interstate Commerce Commission, the Court, and all parties in interest must know whether the principal of the taxes must be paid in full or whether the debtor's estate has the right to pay in instalments over a period of twenty years so much of

the principal as cannot be paid in cash. This privilege was given by the Tax Settlement Acts.

In addition, the Interstate Commerce Commission, the Court and all parties in interest must know whether the principal of the taxes carries interest at three percent per annum as fixed by the Tax Settlement Acts, or penalties of one percent per month as provided by the Railroad Tax Act, or some other compensatory interest. The difference aggregates over $14,000,000.

We submit that since the Bankruptcy Court has taken jurisdiction of the debtor railroad, and all of its funds and property are *in custodia legis*, the Bankruptcy Court has full and complete jurisdiction to make all necessary determinations respecting the questions here involved, what payments should be made by the trustee to the State, and how such payments shall be applied on the State's claim.

B. Under bankruptcy law the State has no lien on the personal property of the debtor.

Proof of Claim No. 38 filed by the State, in answer to the fourth question in the blank, read:

"Security or lien, if any, for said claim:

"Answered in (10) below" (App. 83a).

Referring to question 10 the Proof of Claim said:

"(10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same:

"The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible porperty and fran-

chises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable'' (App. 84a).

It is submitted that under the express provisions of the Bankruptcy Act and applicable decisions the lien of the mortgage securing the bonds issued by the debtor is prior to the claim of the State to have a lien on the tangible and intangible personal property of the debtor located in New Jersey and elsewhere.

Bankruptcy Act, Sec. 67 (b) and (c), (11 U. S. C. A. 107 (b) and (c)):

Bankruptcy Act, Sec. 64 (11 U. S. C. A. 104);

New York v. *Maclay*, 288 U. S. 290;

United States v. *Texas*, 314 U. S. 480;

City of New Orleans v. *Harrell*, 134 Fed. (2d) 399 (C. C. A. 5th);

City of New York v. *Hall*, 139 Fed. (2d) 935 (C. C. A. 2nd).

In re Pennsylvania Central Brewing Co., 114 Fed. (2d) 1010 (C. C. A. 3rd); cert. den. 312 U. S. 685.

Sections 64 and 67 of the Bankruptcy Act are applicable to railroad reorganizations under Section 77.

Lyford v. *New York*, 140 Fed. (2d) 840 (C. C. A. 2nd).

POINT II.

The State repealed its Railroad Tax Law and attempted by a new Tax Act to preserve its taxes as assessed and preserve and extend its lien after bankruptcy had occurred.

The State's Proof of Claim for taxes asserts a lien under par. 10, Sec. 9, Ch. 208, P. L. 1888, as amended and supplemented; Sec. 54:27-4, Revised Statutes, N. J.

This section of the statute, which is a part of the Railroad Tax Act, provides:

> "54:27-4. *Default; penalty; remedies; liens.*
>
> "If the taxes of any company, or any part thereof, remain unpaid on December 1st following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one percent for each month until paid. Notwithstanding the prosecution of a writ of certiorari or other remedy the taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State. The liens shall take effect on June 1st of the year in which the tax is payable and shall be a debt due from the company to the State on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in Chapters 19 to 29 of this Title (Sec. 54:19-1, *et seq.*)."

The above section was repealed by Section 75, Chapter 291, P. L. 1941; (Rev. 54:29A-75 (Pamphlet)), (New Tax Act).

The New Tax Act contained the following provisions:

"54:29A-53. *Interest.* Taxes heretofore imposed pursuant to any law for the taxation of property used for railroad and canal purposes, or hereafter imposed pursuant to this Act, or any unpaid portion thereof, shall bear interest from and after the date upon which they became or may become due and delinquent at the rate of one percentum (1%) for each month until paid notwithstanding the prosecution of a writ of certiorari or other remedy."

"54:29A-54. *Lien of Taxes.* The taxes imposed by this Act or heretofore imposed pursuant to any act for the taxation of property used for railroad and canal purposes, shall be and remain a lien paramount to all other liens upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State. The lien shall take effect as of the 1st day of the year in which the tax is payable."

"54:29A-55. *Tax a debt; preference.* The taxes imposed by this Act or heretofore imposed shall be and remain a debt due from the taxpayer to the State for which an action at law or suit in equity may be maintained and shall be a preferred debt in case of insolvency."

A comparison of the old and the new sections of the Tax Act shows an attempt to extend the lien of the State to assets of the debtor and other railroads that were not covered by the old law. The State now contends that its lien extends to "the *revenues* of the debtor", as well as to personal property *controlled* by the debtor, assets which were not subject to the State's alleged lien prior to 1941.

It is also to be observed that the former law provided that the liens shall take effect on June 1st of the year in which the tax is payable and become a debt from that date,

whereas the 1941 law provides that "the lien shall take effect as of of the first day of the *year* in which the tax is payable". We know of no authority for a creditor, whether it be a State or mortgagee, to change and extend a lien on a bankrupt's property after a petition in bankruptcy has been filed. Upon the filing of the petition in bankruptcy the rights of the bankrupt, or debtor, creditors and stockholders, became fixed.

Straton v. *New*, 283 U. S. 318.

What happened to the lien asserted by the State under the old law, in existence when the petition was filed by the debtor, when the State passed the 1941 Tax Act, which in Section 75 expressly repealed the former law under which the taxes in question were assessed and the liens created?

Were such liens preserved by Section 54 of the repealing Act, which provided that the taxes heretofore "imposed pursuant to any act for the taxation of property used for railroad and canal purposes shall be and remain a lien paramount to all other liens"? The intent, of course, was to preserve the State's rights in all such liens. It was further the intention to extend such liens to the revenues of the Railroad and other property not covered by the original lien.

In *State, Dixon, Pros.* v. *Jersey City*, 37 N. J. L. 39, taxes were assessed under a provision of the Jersey City Charter of 1870, and before the taxes in question were paid a new charter was passed for the City which made no provision for the collection of taxes theretofore assessed, and repealed the 1870 Charter without saving assessments made under it. By a supplement to the Charter of Jersey City of 1872 it was enacted that nothing in the Charter of 1871 should be construed to impair the right which the City had

before the passage of that Act to any taxes or assessments theretofore levied or to any penalties or interest theretofore accrued. The State Supreme Court held:

> "The power to impose the forfeiture attaches as a necessary incident to the right to levy and collect taxes, and on no other ground can it be supported. The penalty thus provided is not taxation; it is merely a method of enforcing the payment of a tax, and it could not be sustained as a distinct measure for raising revenue, separable from the tax itself. The imposition of penalties for past omissions would be sanctioned by no such reason or necessity; it would not be in aid of the collection of the revenue, but would be arbitrary exaction from which the citizen could in no way escape. I can find in no text book nor in any adjudicated case, any definition of taxation which will embrace a proceeding like the one involved in this controversy. It would be confiscation, not taxation."

Concluding his opinion, Justice Van Syckel said:

> "When part of a tax is illegal, all proceedings to collect it must be void, as it is impossible to separate what is legal from what is illegal."

Pennsylvania Tunnel & Terminal Co. v. *Gummere*, 87 N. J. L. 353.

We have no doubt that if a mortgagee, after a petition in bankruptcy had been filed against an individual or corporate debtor, had cancelled his mortgage and simultaneously had taken and recorded from the bankrupt a new mortgage covering property in addition to that covered by the original mortgage, it would be held that the lien of the cancelled mortgage was extinguished even though the new mortgage contained the provision that it "shall be and remain a lien paramount to all other liens" on the property

of the bankrupt. We know of no authority sustaining the right of a State to alter and extend its lien after a court of Bankruptcy had obtained jurisdiction by repealing the old and enacting a new law in the manner indicated. We are confident that an important and novel question was presented by the trustees' petition for the adjudication of the State's liens.

It is respectfully submitted that a writ of certiorari should issue in accordance with the prayer of the trustee's petition.

Respectfully submitted,

JAMES D. CARPENTER, JR.,
HOWARD L. KERN,
ALEXANDER H. ELDER,
Of Counsel with the Trustee.

Appendix.

A. Applicable Provisions of the Bankruptcy Act.

Section 2 a (2) of the Bankruptcy Act (11 U. S. C. A., Chapter 2, Section 11 a (2):

"Sec. 11. Creation of courts of bankruptcy and their jurisdiction

a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, * * * with such jurisdiction at law and in equity as will enable them to * * * (2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates; * * * (7) Cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided, * * * (15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this title: * * *"

Section 57 of the Bankruptcy Act (11 U. S. C. A. 93):

"Sec. 57. *Proof and Allowance of Claims.* * * *

"j. Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

"k. Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, before but not after the estate has been closed.

"n. Except as otherwise provided in this title, all claims provable under this title, including all claims

of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section * * *".

Section 64 of the Bankruptcy Act (11 U. S. C. A. 104a):

"Sec. 64. *Debts Which Have Priority.* The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: Provided, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: And provided further, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; * * *"

Sec. 67. Liens and fraudulent transfers (11 U. S. C. A. 107):

"b. The provisions of section 96 of this title to the contrary notwithstanding, * * * statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter 10, 11, 12, or 13 of this title, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter 10, 11, 12, or 13 of this title, though

valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or any State or subdivision thereof, on personal property not accompanied by possession of such property, * * * shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of Section 104 of this title, * * *"

Section 77(b) (11 U. S. C. A. 205):

"A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (3) may include, for the purpose of preserving such interests of creditors and stockholders as are not otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) * * * (5) * * *"

" * * * The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

"The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character * * *."

B. Chapter 290, Laws of 1941 (N. J.)

CHAPTER 290

AN ACT relating to the collection of certain delinquent taxes upon railroad companies.

WHEREAS, Certain taxes levied for the years 1932 through 1940 upon property used for railroad purposes in this State are delinquent and unpaid, and the total accumulated delinquencies, exclusive of interest penalties, amounted to more than thirty-four million dollars ($34,000,000.00) as of December thirty-first, one thousand nine hundred and forty; and

WHEREAS, Four of the railroad systems serving this State are or have recently been in reorganization under Federal bankruptcy laws, and there is serious doubt as to the ability of the railroads operating in the State to pay the delinquent taxes, and at the same time to continue to furnish adequate and safe service; and

WHEREAS, The limited area of New Jersey and its intensive industrial development make it peculiarly dependent upon efficient transportation, particularly because of the present demands of production for national defense, and immediate payment of accumulated tax delinquencies would impair the capacity of the delinquent railroads to furnish such transportation service; and

WHEREAS, The unpaid railroad taxes have tended to create a chaotic condition in State and municipal finances, and the entire State has an urgent and important interest in the immediate solution of the question of delinquent railroad taxes and in the maintenance of stable transportation facilities and public finances; now therefore,

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Installment payments. The State Treasurer is hereby authorized and required to accept, without interest

penalties, installment payments of the full principal amount of property taxes upon railroad companies, which were due on or before December first, one thousand nine hundred and forty, and remain unpaid on the effective date of this act. But the State Treasurer shall not accept any installment payments under the terms of this act unless and until the delinquent taxpayer shall have complied with the requirements of sections seven and eight hereof.

2. Maximum period. The total principal amount of delinquent taxes payable under this act shall be paid in full, in accordance with the respective capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, determined as the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be determined for each railroad system, and for each company not part of a system, by dividing its total amount of delinquent taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

For the purpose of this act, a railroad system shall be deemed to consist of an operating railroad reporting to the Interstate Commerce Commission for the year one thousand nine hundred and forty and all the companies included in its report of system operations.

3. Date and amount. Installment payments shall be made on or before December first in each year. Each annual installment shall be not less than such amount as, together

with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of delinquent taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under section two of this act.

4. Interest. All interest penalties upon taxes paid pursuant to this act shall be abated and cancelled, except that, in addition to installment payments, interest at the rate of three per centum (3%) per annum shall be paid annually upon the balance of delinquent taxes remaining unpaid from and after December first, one thousand nine hundred and forty.

5. Discharge of lien. The liens of the State for taxes and interest penalties of each year for which delinquent taxes are payable pursuant to this act shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year, and interest upon all unpaid balances has been paid in full.

6. Liens preserved. The remedies of the State for the collection of delinquent taxes payable pursuant to the provisions of this act shall not be enforced against any taxpayer which enters upon the execution of an installment payment plan hereunder, in the manner provided by section seven hereof, so long as installment payments and interest upon the unpaid balances continue to be paid on or before the respective due dates. Upon default in payment of all or part of an installment payable in any year or of interest upon the unpaid balance, the whole remaining amount of delinquencies including interest penalties, shall, subject to the provisions of section five of this act, be reinstated and become due and payable thirty days after the date of default. Nothing in this section shall be construed to deprive any taxpayer of credit for installment payments

upon the principal amount of delinquencies made prior to such default.

7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require.

9. Consents in reorganizations. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of the act.

10. Construction. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under chapters nineteen to twenty-nine of Title 54 of the Revised Statutes; nor shall any provision of this act be construed to authorize or recognize any

claim for any refund, return or credit of all or part of the taxes of any company heretofore paid for any year.

11. Distribution of receipts. The monies collected by the State Treasurer pursuant to this act shall be subject to distribution, opportionment or appropriation as heretofore provided by law. The State Treasurer shall credit receipts hereunder to delinquent accounts in the order in which the delinquent taxes were originally assessed.

12. Effect of unconstitutionality. If any provision of this act, or the application thereof to any person or circumstances, is held invalid, the remainder of this act, or application of such provision to other persons or circumstances, shall not be affected thereby.

13. Effective date. This act shall take effect immediately.

Approved July 22, 1941.

C. Chapter 241, Laws of 1942 (N. J.)

CHAPTER 241

AN ACT to amend the title of "An Act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) so that the same shall read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years," and to amend the body of said act and to supplement said act.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. The title of "An act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) is amended to read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years."

2. Section one of the act of which this act is amendatory and supplementary is amended to read as follows:

1. Any railroad taxpayer desiring to accept the provisions of this act shall, on or before June fifteenth, one thousand nine hundred and forty-two, file with the State Treas-

urer the acceptance document required by this act, providing for the payment in full of the principal amount of all of its unpaid taxes for the tax years involved at the times and in the manner provided by this act and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December first, one thousand nine hundred and forty-one pursuant to the applicable tax acts, and of any assessment heretofore or hereafter made for the tax year one thousand nine hundred and forty-one; and shall also file with the State Treasurer a written consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals respecting any such assessments; and shall also at the same time pay to the State Treasurer the initial payment provided for by this act. The State Treasurer is hereby authorized and required to accept payment of such unpaid taxes when made in accordance with the terms of this act.

3. Section two of the act of which this act is amendatory and supplementary, is amended to read as follows:

2. The total principal amount of unpaid taxes payable under this act shall be paid in full, and such payment may be made in installments as herein provided, in accordance with the respective capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, which shall be the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be computed for each railroad system, and for each company not part of a system, by dividing its total amount of unpaid taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for

the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

4. Section three of the act of which this act is amendatory and supplementary is amended to read as follows:

3. The initial payment to be made under this act shall be made on or before June fifteenth, one thousand nine hundred and forty-two, and shall be an amount not less than the first annual installment computed as herein provided. After the payment of the initial installment on or before June fifteenth, one thousand nine hundred and forty-two, as required by this act, an additional installment payment shall be made on or before December first, one thousand nine hundred and forty-two, and in each year thereafter on or before December first of said year. Each such annual installment shall be not less than such amount as, together with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of unpaid taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under this act.

All such unpaid taxes shall bear interest at the rate of three per centum (3%) per annum, to be calculated from and after December first, one thousand nine hundred and forty. The initial payment shall include such interest to the date of such payment; and each subsequent payment shall include interest at such rate on the unpaid balance of taxes calculated from the date of the next preceding installment payment. Any railroad taxpayer may, however, at the time or times herein specified for the payment of any installment of such taxes, pay the whole amount of taxes then remaining unpaid, together with the interest thereon as herein provided for, or it may at such time or times make payments in amounts in excess

of the required installment payments, together with interest as provided in this act; or such taxpayer may make payment of any installment of taxes payable under this act in advance of the time or times specified by this act, together with the interest accrued to the date of such payment; and in any of such events, further interest shall cease with respect to the amount of the taxes so paid from the date of the payment thereof. Payments made by any railroad taxpayer shall be applied first to the payment of interest at three per centum (3%) per annum as provided by this act, and the amount of any payment in excess thereof shall be applied to the unpaid taxes owing by such taxpayer, in the order in which such taxes became payable under the applicable tax acts.

Should any railroad taxpayer so direct in the acceptance document filed pursuant to this act, the State Treasurer is hereby authorized and required to collect the amount of any drafts or checks heretofore delivered to him by such railroad taxpayer in attempted compliance with the provisions of pamphlet laws of one thousand nine hundred and forty-one, chapter two hundred ninety, and to credit the same to the payments required to be made by such taxpayer under this act. If the amount of any such draft or check is less than the amount of taxes and interest required to be included in the initial payment, such taxpayer at the time of filing its acceptance document shall pay the balance of the initial payment required by this act.

5. Section four of the act of which this act is amendatory and supplementary is amended to read as follows:

4. Upon the acceptance of the provisions of this act by any railroad taxpayer, and as long thereafter as such railroad taxpayer shall make payment of the unpaid taxes and interest required by this act, there is and shall be stayed and suspended any remedy or proceedings to collect any unpaid taxes for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and any statutory interest penalties with respect to any taxes assessed for said years.

6. Section five of the act of which this act is amendatory and supplementary is amended to read as follows:

5. Whenever any railroad taxpayer accepting the provisions of this act heretofore has paid, or hereafter shall have paid, as required by this act, the full amount of all taxes assessed upon its property used for railroad purposes for the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and all interest, if any, required by this act, such taxpayer and its property shall be released and discharged from any and all claims for statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any and all of the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

7. Section six of the act of which this act is amendatory and supplementary is amended to read as follows:

6. Upon default in the making of any payment provided for in the acceptance document, and a continuance thereof for a period of thirty days after the due date of such payment, the then remaining unpaid balance of taxes, together with statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, calculated from the original due date of such taxes shall immediately become due and payable, and the State may assert, exercise and enforce any and all rights, claims, demands, liens and privileges with respect thereto as if this act had not been enacted, and in addition thereto may assert and enforce any remedies it may have acquired under such acceptance document except that such taxpayer shall be entitled to a credit against such statutory interest penalties in an amount equal to the interest paid pursuant to the provisions of this act.

8. Section seven of the act of which this act is amendatory and supplementary is amended to read as follows:

7. The acceptance document herein referred to shall be in substantially the following form:

ACCEPTANCE AND WAIVER

The (insert name of railroad or system) does hereby accept the provisions of (insert the amended title of this act), and hereby undertakes and agrees to pay to the State of New Jersey in the manner and at the times prescribed by said act the sum of (insert total amount of taxes unpaid on December 1, 1940), being the total principal amount of taxes remaining unpaid on December 1, 1940, which were theretofore assessed against or levied upon the property used for railroad purposes for the years 1932 to 1940, inclusive, of the (insert name of railroad or system) together with interest thereon, to be computed at the rate of three per centum (3%) per annum from and after December 1, 1940.

(If any railroad taxpayer has heretofore delivered or tendered a draft or check to the State Treasurer on account of any part of such taxes or interest in attempted compliance with the provisions of P. L. 1941, chapter 290, the following clause may be added) "and said (insert name of railroad or system) does hereby authorize and direct the State Treasurer of New Jersey to retain and accept the draft or check heretofore delivered to him on the .....
..... day of .....,
1941, in the amount of .....
dollars, and to collect and credit the same upon the initial payment required to be made by this act."

And said (insert name of railroad or system) for itself and the following companies whose railroads are included in its system, to wit (list of companies) does hereby waive any and all rights under the laws of the State of New Jersey and of the United States to contest the legality or amount of any assessment upon its or their property used for railroad purposes made prior to December 1, 1941, pursuant

to the applicable tax acts and of any assessment heretofore or hereafter made for the tax year 1941.

In Witness Whereof said (insert name of railroad or system) has caused this instrument to be sealed with its corporate seal and attested by its officers thereunto duly authorized, this ..... day of ....., 1942.

(Seal)

(Signatures)

9. Section eight of the act of which this act is amendatory and supplementary is amended to read as follows:

8. The consent to the discontinuance and dismissal of pending appeals and litigation shall be in substantially the following form:

DISCONTINUANCE AND DISMISSAL

(Name of Court or tribunal)

(Names of parties to proceeding)

In re Assessments for (insert tax year)

On motion of (insert name of taxpayer or appellant) it is on this day of , 1942

Ordered that the appeal (or other proceeding) with respect to the taxes and assessments of the property of (insert name of taxpayer or appellant) used for railroad purposes for the tax year be and the same is hereby discontinued and dismissed.

We consent to the foregoing order.

(Signature of attorney for taxpayer or appellant)

10. Section nine of the act of which this act is amendatory and supplementary is amended to read as follows:

9. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents and approvals to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of this act.

11. Section ten of the act of which this act is amendatory and supplementary is amended to read as follows:

10. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under the applicable tax acts; nor shall any provision of this act be construed to authorize or recognize any claim for any refund, return or rebate of any part of any taxes of any company heretofore paid for any year by any railroad or system.

12. Section eleven of the act of which this act is amendatory and supplementary is amended to read as follows:

11. The moneys collected by the State Treasurer pursuant to this act shall be subject to distribution, apportionment or appropriation as heretofore provided by law.

13. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

14. As used in this act:

(a) The phrase "tax years involved" is defined to mean any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, both inclusive.

(b) The phrase "applicable tax acts" is defined to mean all statutes providing for the assessment and collection of taxes on property used for railroad purposes in effect for any or all of the tax years involved.

(c) The phrase "railroad taxpayer" is defined to mean any railroad system or railroad not part of a system owning or operating a railroad in this State, or the duly appointed and qualified receiver, receivers, trustee or trustees thereof, whose property used for railroad purposes has been assessed for taxes for any of the tax years involved, pursuant to the applicable tax acts as herein defined.

(d) The phrase "statutory interest penalty" is defined to mean the one per centum (1%) per month charges provided by the applicable tax acts or by any other act to be collected in the event of the failure to pay the taxes assessed under the applicable tax acts at the times specified therein.

(e) The word "interest" is defined to mean the interest at three per centum (3%) per annum provided to be paid by this act.

(f) The phrase "acceptance document" is defined to mean the instrument referred to in section seven of this act.

(g) The phrase "railroad system" is defined to mean an operating railroad company reporting to the Interstate Commerce Commission for the year one thousand nine hundred and forty and all companies included in its report of system operations.

14. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

15. The purpose and object of this act is to provide for the payment by railroad taxpayers of unpaid balances of taxes assessed for the tax years involved, pursuant to applicable tax acts, upon property used for railroad purposes in this State, and to that end, it is hereby determined and declared:

Beginning with the year one thousand nine hundred and thirty-two and continuously thereafter, this State, at great expense and with considerable interruption to the orderly disposition of other tax review proceedings by State tribunals, has been engaged in litigation concerning

the validity and amount of assessments upon property used for railroad purposes in this State; and litigation involving substantial amounts of taxes and debatable questions of law and fact relating thereto are still pending and undetermined for certain of the tax years involved.

The development of competitive transportation facilities, the more general use of fuels other than coal, the shrinkage of export rail traffic destined to the Port of New York, the decentralization of industry and other causes, as well as the economic depression of the past decade, adversely affected the financial position and progress of the railroads operating in New Jersey, and although the income of such railroads was substantially decreased from former levels, the tax obligations of such railroads were not materially reduced.

The statutory interest penalty provisions of the applicable tax acts have not proven effectual to accomplish their purpose of assuring prompt payment of taxes, and unpaid balances of taxes for the tax years involved now exceed in the aggregate thirty-four million dollars ($34,000,000.00), exclusive of any claims of the State for statutory interest penalties relating to taxes assessed for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

The prosecution of statutory legal proceedings under the applicable tax acts to enforce collection of unpaid balances of taxes and statutory interest penalties for the tax years involved has been accompanied by the institution and prosecution by certain railroad taxpayers of appropriate proceedings under Federal bankruptcy laws, resulting in the appointment of receivers or trustees of certain of such railroad taxpayers and their properties. Several railroad taxpayers of this State, whose taxes are in part unpaid, are now involved in such proceedings. It is probable that similar proceedings may be undertaken with respect to other railroad taxpayers and their properties if existing statutory collection proceedings are continued or new proceedings instituted.

Wherever claims for unpaid taxes and statutory interest penalties have been filed on behalf of the State in such bankruptcy proceedings, the provability of the amount of the claims of the State has been questioned and objections have been filed by the receivers or trustees in reorganization to the allowance thereof. Litigation arising in connection therewith is pending in various Federal courts in which the bankruptcy proceedings are pending.

The delay and uncertainty in the collection of the unpaid balances of railroad taxes has created a chaotic condition in State and municipal finances and such tax moneys are urgently needed to pay existing and potential costs of government. It is imperative that a substitute and more effective and feasible method for the collection of such unpaid balances of taxes be provided promptly.

To meet the existing national emergency and aid the effective movement of armed forces and supplies, so that this State and the nation may be protected, it is essential that the railroads in this State be not financially harassed by the continued attempt to collect statutory interest penalties with respect to the taxes assessed for the tax years involved.

For more than fifty years last past, it has been the well recognized and approved public policy and practice of this State and its various agencies and subdivisions to meet financial emergencies resulting from long periods of financial depression by compromising, adjusting, abating and altering the amount and method of payment of obligations of taxpayers.

This Legislature has given consideration to investigations, recommendations, hearings and reports made by various public officials, legislative and other committees, both during the current legislative year and prior thereto, in the matter of taxes assessed on property used for railroad purposes, and has particularly given consideration to a report on the subject made by the Joint Legislative Committee constituted by Senate Concurrent Resolution No. 8 of the one thousand nine hundred and forty-one Legislature, and a report dated

February twenty-second, one thousand nine hundred and forty-one, made by a citizens committee appointed by His Excellency, Charles Edison, Governor of this State.

Certain railroad taxpayers have heretofore attempted to accept the provisions of this act as originally enacted, and as a result thereof, the State Treasurer now has in his possession drafts and checks in an amount in excess of ten million dollars ($10,000,000.00). Questions having arisen respecting the validity and construction of this act as originally enacted, such funds may not be presently available for use by either the State or its various agencies and municipalities. Should changes in financial status result in such drafts or checks becoming uncollectible, or should some or all of such railroad taxpayers undertake to withdraw such drafts or checks and all instruments filed in attempted compliance with said act, serious legal and financial questions may arise as to the rights of the State.

This Legislature has also considered the report made to it by its committee appointed pursuant to Senate Concurrent Resolution No. 2 of the one thousand nine hundred and forty-two Legislature.

After due deliberation and consideration, it is determined and concluded that the existing claims, controversies and litigation above mentioned can best be disposed of, and that the unpaid balances of taxes assessed upon property used for railroad purposes for the tax years involved can best and most quickly be collected, in the manner and upon the terms and conditions herein provided, and that upon the acceptance of, and compliance with, such terms and conditions by any railroad taxpayer the State will have received full, fair and adequate consideration, and the best interests of the State will have been served and furthered.

15. If any provision of this act or the application thereof to any person or circumstances is held invalid, the remainder of this act, or the application thereof to other persons or circumstances, shall not be affected thereby.

16. This act shall take effect immediately.

Approved May 21, 1942.